BRIEF IN SUPPORT OF PETITION

The purpose of this Brief is to amplify the Petition as regards the facts of the case and the reasons upon which petitioner relies for the issuance of the writ, but only to the extent these have not already been covered in the Petition.

The opinion of the Tax Court of the United States (23-39)* is reported at 1 T.C. 629. The opinion of the Circuit Court of Appeals (103-105) is reported at 143 Fed. 2d 695. Statements as to the statutes involved, the questions presented and this Court's jurisdiction to review are set out at pages 3-5 of the Petition.

Statement of Facts

All of the facts have been stipulated (24).

Henry H. Rogers died testate and a resident of New York on July 25, 1935. Adrian H. Larkin (now deceased), Albert Stickney and Central Hanover Bank and Trust Company were named as executors and trustees in the will and qualified in both capacities (24, 51).

Among the assets of the Estate at the decedent's death were 24,248 shares of the common stock of The Virginian Railway Company, which at that time had an aggregate fair market value of $1,454,880. On January 19, 1937 (in conjunction with similar sales by others) the executors sold these shares for a total consideration of $3,209,222, producing a gross profit realized or to be realized of $1,754,342, or 54.6656% of the total contract price. Of the total consideration received by the Estate, $2,400,000 was represented by collateral trust serial notes of the purchaser (The Virginian Corporation) taken at their face amount, maturing $72,000 in each year from 1940 to 1951 and the

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* References are to pages of the Transcript of Record.

balance of $1,537,000 in 1952. These notes, together with others issued by the purchaser in similar transactions, were secured by the railway stock which the purchaser thus acquired and which constituted its only asset and activity (24-27, 52-55, 61).

In the Estate's 1937 income tax return the executors reported this transaction on the installment basis, returning as gain from the sale 54.6656% of the down payment,—as subsequently upheld by the Tax Court. As the stock had been held for more than one but less than two years (from date of death to date of sale), only 80% of the gain on the down payment was taken into account (26-27, 61-62).

Under the decedent's will, the residuary estate was to be divided into three equal shares and held in trust by the same three persons who were named as executors. The income of the three trusts was to be paid respectively to the decedent's widow, daughter and grandson, with remainders over, and in the event the widow remarried one-half of the share held in trust for her was to be paid over to the daughter (29-30, 64-87).

Following the receipt of the $2,400,000 of collateral trust notes, they were entered on the Estate's accounts as part of its corpus. On November 6, 1937 $1,250,000 of the notes were eliminated from the accounts of the Estate, transferred in the Bank's vaults from an envelope marked with the name and descriptive number of the Estate to envelopes similarly marked for the three trusts, and entered on the accounts of the three trusts,—$500,000 for the daughter's trust, $500,000 for the grandson's trust, and $250,000 for the widow's trust, as she had remarried. For this reason, an additional $250,000 of the notes were eliminated from the accounts of the Estate and were held by Central Hanover Bank and Trust Company in escrow for the daughter, under a receipt and refunding agreement whereby the interest was to be paid to her and the notes or proceeds thereof were to be held and returned to the Estate if the residuary estate should prove inadequate to pay all debts, claims and expenses. The executors' accounts for the

period including the year 1937 were approved by the Surrogate's Court; a schedule attached to one of the accounts, entitled "Payments of Principal to or on Behalf of the Beneficiaries", recorded the payment of $1,250,000 of the notes to the trustees of the three trusts and of $250,000 of the notes to the Bank as escrow agent for the daughter (30-31, 55-61, 89-99).

Each trust filed income tax returns for the years 1938-41. During these years some of the notes held by the trusts were sold or redeemed, and in the trusts' income tax returns the amounts so received were reported as gain from the payment of installment obligations, i.e., 54.6656% of the amount received was reported as gain to be taken into account at a proper percentage in computing net income. None of the amounts so received was distributed to the life beneficiaries of the trusts. All interest collected on the notes while held by the trustees was reported in the income tax returns of the respective trusts (31, 62-63).

Of the $2,400,000 notes received by the Estate in 1937, the remaining $900,000 were in 1939 eliminated from the accounts of the Estate in similar manner, $750,000 being entered on the accounts of the trusts in the same proportions as previously, and $150,000 held in escrow for the daughter (31, 61).

Argument

I

Under the provisions of Section 44 (d) of the Revenue Act of 1936, the privilege of reporting gain on the installment basis is terminated when the seller engages in one of the transactions specified in that section, and all the remaining gain is taxed at once in the year such transaction occurs. The Committee Reports on the Revenue Act of 1928, which added Section 44 (d) to the law, state:

> "Subsection (d) contains new provisions of law to prevent evasion of taxes in connection with the

> transmission of installment obligations upon death, their distribution by way of liquidating or other dividends, or their disposition by way of gift, or in connection with similar transactions."*

Although it is obvious that the shift of the notes in the present case from one set of accounts to another does not come within any of the specific purposes named in the Committee Reports, the court below has, by its reliance on the *Maguire* and *Gambrill* cases,** decided that the bookkeeping transactions herein amounted to a "distribution" of installment obligations under Section 44 (d). Correctly understood, however, these and three other cases*** decided in the same year give an entirely different meaning to "distribution".

Where property is acquired by a remainderman under a will there are three separate points of time which might be of importance for income tax purposes. The first is the date of death or (as to property purchased by the executor) the date of purchase; the second is the date when the executor hands over the property to the testamentary trustee; and the third is the date when the trust falls in and the trustee actually delivers the property to the remainderman. In each of the five 1941 cases the taxpayer contended that the third event controls, but this Court, after careful con-

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* Report of Committee on Ways & Means, Revenue Bill of 1928, 70th Cong., 1st Sess., H. Rept. 2, p. 16; Report of Senate Finance Committee, Revenue Bill of 1928, 70th Cong., 1st Sess., S. Rept. 960, p. 24.

There is no possibility of tax evasion where the "distribution" of an installment obligation is made by an executor to a testamentary trustee, as the trustee will take the same basis as the executor and will return all unrealized gain when and if collected (as the trustees did here). Regulations 94, Article 113 (a) (5)-1(e).

** *Maguire* v. *Commissioner*, 313 U. S. 1 (1941); *Helvering* v. *Gambrill*, 313 U. S. 11 (1941).

*** *Helvering* v. *Campbell*, 313 U. S. 15 (1941); *Helvering* v. *Reynolds*, 313 U. S. 428 (1941); and *Cary* v. *Commissioner*, 313 U. S. 441 (1941).

sideration of the whole question under all of the Revenue Acts theretofore enacted, reaffirmed the doctrine that fundamentally the significant event is that which occurs on the first date, i. e., date-of-death or date-of-purchase. Because of the special command of Congress in the 1928 and 1932 Revenue Acts that for determining the basis of general bequests of personalty the critical date is the date of "distribution to the taxpayer," the Court in the three cases under these Acts was forced for this one limited purpose to adopt the second date,—when the executor hands over the property to the trustee.

In the *Maguire, Gambrill* and *Campbell* cases, the opposing parties were neither of them asking this Court to approve the first date, but only to choose between the second and third dates. When this Court said that "distribution to the taxpayer" is not necessarily restricted to actual delivery to the taxpayer but also "aptly describes" the case where property is delivered by the executors to the trustees, this Court was of course in no sense holding or even implying that "distribution" would not also aptly describe the first date in cases not governed by the "limited departure" of the 1928 and 1932 Acts.* And when this Court came to deal with cases arising under the 1934 Act (*Helvering* v. *Reynolds* and *Cary* v. *Commissioner*), the Court again reverted to the date-of-death or date-of-purchase rule as the expressed intent of Congress.

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* See *Maguire* v. *Commissioner,* 313 U. S. 1, 7, 8, where this Court said: "In *Brewster* v. *Gage,* 280 U. S. 327, 334, this Court held under earlier acts that the date of death was the date of 'acquisition' even in case of a residuary legatee whose interest at the date of death clearly was not absolute. That conclusion suggests that the critical date is the time when the legatee acquires some interest in the property although his interest then may not be unconditional. Hence, in case of remainders governed by § 113 (a) (5) of the 1928 Act, it cannot realistically be asserted that the date when the remainderman acquired his interest came later than the time when he obtained an equitable estate under the testamentary trust."

The court below, apparently over-emphasizing the effect of the reversal of *Commissioner* v. *Gambrill,* 112 Fed. 2d 530 (1940), by *Helvering* v. *Gambrill, supra,* and taking the language of the *Maguire* case as to "distribution" out of its context, reached a result which is in direct opposition to the views of this Court as set forth in the 1941 cases and in *Brewster* v. *Gage.* Under the fundamental rule laid down by this Court distribution takes place when the remainderman acquires his interest in the property, i. e., at the date of death or date of the executor's purchase. In the present case, accordingly, the subsequent shift of the notes from the executors' to the trustees' accounts was an incidental step of no tax significance, and not one of the kind on which Congress thought it necessary to fasten the drastically accelerated tax under Section 44 (d).

II

The importance of the question as to whether the capital-gain (i. e. the income) component of an installment obligation becomes transmuted into corpus when the obligation is shifted from executors to themselves as trustees is so great, and its resolution by the court below so imbedded in the pattern of confusion which has emerged from other Circuit Court decisions, that the whole problem deserves reexamination by and illumination from this Court.

By the force of Section 44 (d) the executors of petitioner were in receipt of capital gain in 1937. They did not retain the gain so received but transferred it over, during the same taxable year, to their trustee accounts. The question upon which we are asking this Court to pass is whether what was admittedly income, and what was admittedly paid over in the same year with the approval of the local court in the course of carrying out the wishes of a decedent, retains its character as income, or loses it by the mere touch of the executors' hands.

Congress plainly intended that all estate income should be taxed to someone (see *Helvering* v. *Butterworth,* 290 U. S. 365 (1933)), and Section 162 evidences the desire of Congress that the person who should pay the tax on such income is the person who currently receives and retains it. The tax ought not to be imposed on the person who has distributed the income and thus parted with the wherewithal to pay the tax thereon, but on the person who has received and retained the income. We do not think that this sound principle of taxation should be subverted by the judge-made concept that Federal taxable income passing through a conduit can be changed by local law into Federal exempt corpus.

The confused development of this concept in various Circuit Court decisions, as we pointed out in the Petition on page 10 and its footnote, is grounded on a dictum in *Burnet* v. *Whitehouse,* 283 U. S. 148 (1931). The direct holding of that case, however, has been found out of harmony with sound principles of taxation, as shown by the action taken by Congress in Section 111 of the Revenue Act of 1942, amending Sections 22(b)(3) and 162. The Report of the Committee on Finance on the Revenue Bill of 1942 (77th Cong., 2d Sess., Senate Rept. No. 1631, p. 69 *et seq.*) states that the law is being changed, in the case of annuities payable at intervals, to provide that to the extent there is income in the estate from which the annuities are derived the payments shall be treated as income to the recipient regardless of whether the payments are made out of income or corpus. What Congress was changing was the rule laid down in *Burnet* v. *Whitehouse, supra,* and *Helvering* v. *Pardee,* 290 U. S. 365 (1933), both of which held in effect that income could become corpus in passing through the hands of a fiduciary and hence could be exempted from tax in the hands of the beneficiary. Although the 1942 amendments needed to deal only with recurrent payments rather than isolated capital gains, they recognized the basic principle for which we contend, namely, that the character of income is not changed by its passage through

the hands of a fiduciary. In this connection, the Committee Report is illuminating. It says, referring to the *Whitehouse* and *Pardee* cases:

> "This construction of existing law results in payment of the tax by the trust upon income received by a beneficiary, and, accordingly, in some cases furnishes an instrument for tax avoidance by the beneficiary and in some cases results in hardship to other beneficiaries whose share of trust income is reduced by the taxes paid for the benefit of another."

It is our earnest contention that the doctrine followed by the court below,—which would transmute income into corpus in the course of the devolution of a decedent's estate before that income reaches its destination—represents so marked a deviation from the real intention of Congress in this regard that the matter should be reviewed and corrected by this Court.

III

Since its enactment in 1928 Section 44 (d) has provided that if an installment obligation is distributed or disposed of, etc., "gain or loss shall result". The provision as to the applicable holding period on such an event was added by the 1934 Act, as follows:

> "Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received."

Thus the time at which the statute directs that the gain or loss shall "result" is the time at which the installment obligation is disposed of. And though the gain or loss actually results at that time because of the disposition of the obligation, the added sentence directs that it shall be considered as resulting (at that time) from the sale or exchange of the original property. The original property,

in other words, is to be considered as being continuously held down to the time at which the gain or loss results.

When a capital asset is disposed of the percentage of gain or loss under Section 117 (a) is ordinarily determined by the length of time the asset was held, which here would be the time the installment obligation was held. The added sentence prevents the holding period from being thus confined when the gain or loss is accelerated under Section 44 (d), and substitutes an enlarged period expressed in terms of the time which the original property shall be considered as being held. The holding period thus begins when the original property was acquired and ends when the installment obligation is disposed of. This reaches the same result as the "tacking" permitted by Section 117 (c) in other cases where the property was received in a non-taxable transaction or with a substituted basis.

Though the statute seems clear, the Committee Report on the Revenue Bill of 1934 is not. The new sentence was added to the bill in the Senate, and the Senate Finance Committee Report (73d Cong., 2d Sess., S. Rept. 558, p. 29) states as follows:

> "This amendment to the House bill makes it clear that where the profit on the sale or exchange of property is returned on the installment basis by spreading the profit over the period during which the installment obligations are satisfied or disposed of, such profit shall be taken into account under the brackets set forth in section 117 of the bill according to the period for which the original property sold was held rather than according to the period for which the installment obligations were held. For example, A sells property held for six years for twice its cost and returns the income on the installment basis. A year and a half later A sells a $100 note received on the sale for $80. Applying the amendment, the $30 profit recognized comes under the 40 per cent bracket of section 117 and not under the 80 per cent bracket."

It is plain enough from this Report that the applicable holding period was not intended to consist of the period during which the installment obligation itself was held, but beyond this the Report is ambiguous. In the example given, the 80 per cent bracket for 1-2 years could apply only if the time the note was held controlled,—which Congress obviously did not intend. The 40 per cent bracket for 5-10 years, however, would apply whether the holding period was considered to be the time the original property was held (6 years) or the combined time of the holding of the property and the note (7½ years).

In view of the inconclusive nature of the Committee's remarks, we think this question deserves examination by this Court with a view to determining whether the intention of Congress is that which clearly seems to appear from the language of the statute or is what the court below thought after reading the Report.

Conclusion

This case involves matters of general public interest and importance in the administration of the Federal Income Tax Law which have been decided by the court below in conflict with the decisions of this Court. The questions should therefore be reviewed by this Court and a writ of certiorari should issue for that purpose as prayed in the foregoing Petition.

Respectfully submitted,

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